

Board of Governors of the Federal Reserve System

**REPORT ON THE AUDIT OF THE BOARD'S
OUTSOURCING OPERATIONS**



OFFICE OF INSPECTOR GENERAL



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

OFFICE OF INSPECTOR GENERAL

April 15, 2004

Governor Mark Olson
Chair, Committee on Board Affairs
Board of Governors of the Federal Reserve System
Washington, DC 20551

Dear Governor Olson:

The Office of Inspector General of the Board of Governors of the Federal Reserve System (Board) is pleased to present its *Report on the Audit of the Board's Outsourcing Operations* (A0207). We conducted this audit to assess the Board's contract management for outsourced services and to evaluate the process for identifying and evaluating other outsourcing and competitive sourcing opportunities. To accomplish our objectives, we obtained information on forty-three open contracts with vendors providing some level of outsourced services to nine Board divisions. We reviewed in detailed fifteen of these contracts that were judgmentally selected based on division coverage, dollar value, vendor selection method, start date, and frequency of contract modification. In addition, we interviewed various Board officials and staff associated with the outsourcing process and the contracts selected. We also compared the extent of the Board's outsourcing activities with those of other financial regulatory agencies and other government agencies by reviewing their Federal Activities Inventory Reform Act of 1998 (FAIR Act) submissions to the Office of Management and Budget (OMB) or their description of outsourced activities available on their Internet web sites.¹ We conducted our fieldwork between September 2002 and July 2003. Our audit was conducted in accordance with generally accepted government auditing standards.

The Board's *Outsourcing Policy* states that, "... to conduct its operations as effectively and efficiently as possible, the Board may find it advantageous to outsource (use outside contractors for) certain functions ...". The policy also describes the process for identifying, justifying, and implementing outsourcing opportunities, requiring that any outsourced service be

¹ The FAIR Act provides a process for most other government agencies to identify activities that are performed which are not inherently governmental in nature and promotes competition from the private sector in order to help the government realize cost savings. The act requires government agencies to publicly list activities eligible for outsourcing under federal guidelines established in OMB Circular A-76. Agencies are to submit their lists to and consult with OMB; and to review activities on the list and determine whether any of them should be outsourced. Agencies are expected to evaluate comments from the public regarding the content of the lists after they have been submitted to the Congress and published for public comment. In 1999, the Legal Division issued an opinion that the Board is not subject to the act.

readily available from the commercial sector and that the service (1) can be obtained at significantly lower prices, (2) can be easily replaced through internal staffing if prices and/or quality changes occur in the marketplace, and (3) does not represent an inherently governmental function. According to the policy, “. . . an inherently governmental function generally is one that is so related to the public interest as to mandate its performance by government employees. These functions include the formulation of Board policies, including monetary policy analysis and implementation; bank supervision and regulation; supervision of Board employees; contract management; and other activities as determined by the Staff Director for Management.” Once a decision is made to outsource an activity, the process for contracting for such services is governed by the Board’s *Acquisition Policy*, which specifies requirements and responsibilities for developing statements of work, obtaining and evaluating bids or proposals, reviewing contract terms and conditions, and administering contract terms.

To date, the Board has outsourced all or portions of its grounds keeping functions, janitorial services, cafeteria services, shuttle bus service, graphics and printing functions, retirement system and benefits administration, health services, travel service, courier service, and most recently its initial mail screening and handling functions. In addition, the Board has contracted for various types of service personnel, such as systems analysts, security personnel, benefits specialists, and personnel recruiters to supplement the work of its employees. In 2002, the Board spent about \$7.6 million on forty-three contracts for outsourced services.

Our audit identified a number of areas for improvement regarding the Board’s outsourced activities that will require the efforts of the Procurement Section, the divisions requesting services, and the Legal Division (Legal). We have three recommendations designed to enhance the management of outsourcing contracts and the Board’s overall outsourcing approach.²

- 1. We recommend that the Management Division (MGT) enhance controls to ensure that statements of work and contracts for outsourced services specify the expected vendor performance, results, and level of service; standards for performance measurement; and incentives or penalties, as appropriate, based on the actual level of vendor performance.**

We found that the outsourced contracts we reviewed contained statements of work outlining what the contractor was expected to do; however, only three of the fifteen contracts contained a clear description of the results or performance the Board was expecting. Of these three contracts, only the one for cafeteria services included incentives for exceeding expectations and only the one for janitorial services included financial penalties for poor performance. We also found that unclear performance expectations in three other contracts led to significant change orders and contract modification, adding to the cost of contract administration.

² During the course of this audit we identified one outsourced contract where administrative controls failed to prevent the vendor from being paid amounts that exceeded those approved under the contract. Our findings regarding this contract will be reported separately.

An effectively worded performance-based contract helps ensure that vendors provide required services at best value to the Board in much the same way as clearly stated performance expectations are critical to ensuring that the Board gets the maximum value from the work performed by its employees. Best practices for outsourcing indicate that contracts should 1) describe requirements in terms of results, not methods of performance, 2) set measurable standards for performance, 3) describe how vendor performance will be evaluated in a quality assurance plan, and 4) identify positive and negative incentives when appropriate. Based on our discussions with division and contracting officials, we believe that MGT needs to enhance controls in this area by communicating to division officials and to procurement staff the key performance elements that are to be addressed in an outsourced contract statement of work, and by implementing additional controls, such as a pre-signature, quality assurance review of the statement of work, to ensure that all elements are effectively addressed.

2. We recommend that Legal review all contracts involving outsourced services to help mitigate legal risks.

The *Acquisition Policy* specifies requirements for Legal review based on contract size or type. We found contracts where these reviews were performed too late to add value, were inconsistent or incomplete in the coverage of relevant issues, or were not adequately documented in the contract file. Specifically, we observed the following:

- Legal's review of an outsourced contract for computer security reviews raised issues regarding the contract type and acquisition method after the vendor had nearly completed all work. Similarly, Legal was not asked to review a large dollar value competitive acquisition for printing services until the contract was about to be signed with the selected vendor. This review did not meet the *Acquisition Policy's* requirement that Legal review any standard solicitation with an estimated value exceeding \$250,000 before the solicitation is issued. As a result, Legal commented only on the contract language and did not review the solicitation and contract award process.
- Vendors were not consistently required to comply with the prevailing wage provisions of the Service Contract Act, which would apply to services such as cafeteria, landscaping, shuttle, and janitorial maintenance. Specifically, the contracts for cafeteria services and landscaping service did not include the routine contract language requiring compliance with the Service Contract Act. In addition, with the exception of the contract for janitorial services, we found no evidence of wage determinations that would allow the Board to assess vendor compliance.
- Legal has not issued, for all relevant contracts, written determinations of the applicability of common law factors to the employment status of the individuals and firms retained by the Board to perform the outsourced functions. Legal's rationale for a negative determination on one human resources contract suggests that some of the common law factors may apply

to information technology personnel obtained under certain basic ordering agreements. If so, the Board may potentially incur risk of tax and benefits liability with regard to these personnel.³

- A standard set of contract provisions is being included in most contracts even though such provisions do not necessarily apply, as written, to particular outsourced contracts.
- Legal documents its required reviews of higher dollar value contracts by initialing contract documents or by providing a memorandum to contracting officials. Such documentation was not always included in the contract file to confirm that required Legal reviews were performed or was of insufficient detail to show what the review covered or how contracting officials acted on the comments. For example, we were provided a Legal memorandum that informed the contracting officer that the Service Contract Act applied to a contract for computer repair services. This memorandum was not in the contract file and there was no evidence in the file that the Board required the vendor to comply or, alternatively, an explanation as to why Legal's guidance was not followed.

We have raised similar issues regarding Legal's relationship with procurements in previous audit work. For example, in our September 2002 *Report on the Audit of the Board's Security-Related Directed Procurements* (A0203) we also recommended that Legal review all directed procurements to mitigate various legal and performance risks that we identified during the audit. In response to our recommendation, the director of the MGT expressed concerns about the value and timeliness of Legal's review in these cases, and with procurements in general. The director cited the need for his division to work first with Legal to define and document Legal's role in the procurement process. It is evident from our findings related to Legal's review of outsourced contracts that MGT and Legal have not yet developed the communication and coordination processes to ensure and document a timely, quality review of relevant legal issues pertinent to outsourced contracts. Resolving this issue may require more direct involvement by the Committee on Board Affairs.

3. We recommend that the Board develop a more proactive, strategic approach to outsourcing that is linked to workforce planning activities.

We believe the Board will not achieve its policy statement goal of using outsourcing to help conduct Board operations in the most effective and efficient manner possible unless a more proactive, strategic approach is taken to identify and analyze its delivery of non-inherently governmental functions. The *Outsourcing Policy* recognizes that to be effective, every function performed by the Board's staff should be reviewed during the budget formulation process to determine its potential for successful outsourcing. However, there is no requirement that such

³ An employer who decides to utilize the services of an independent contractor must be cautious in how the relationship is handled, because mischaracterizing the relationship may result in adverse consequences for the employer both as to tax liability and benefits liability. While there is no mechanistic formula that will yield an absolute determination of the correct status (employee v. independent contractor) of an individual, the consistent, good faith application of the Internal Revenue Service-delineated factors will help to ensure that the Board has properly considered the question, thereby reducing the risk of treating outsourced contract personnel as employees.

reviews be documented and no major incentive for divisions and offices to perform an analysis of their non-inherently governmental functions given the incremental budgeting process of the Board and the potential negative human capital issues surrounding outsourcing decisions.

We observed that the Staff Planning Group information request for the current planning and biennial budgeting cycle did not reference the requirements of the *Outsourcing Policy* and was more limited, asking divisions to list and discuss those activities that would be scaled back, eliminated, or outsourced if required to take a permanent budget cut. Further, MGT officials told us that they believe that most outsourcing opportunities have already been implemented. However, our comparison with other agencies indicated that those agencies are outsourcing other functions such as payroll, procurement, and accounting services.

The Board, like many federal agencies, faces important management and personnel challenges, especially as significant numbers of its workforce age and approach retirement. According to a recent panel of experts that studied the current processes the government uses in making sourcing decisions, outsourcing is inextricably linked to human resource and human capital policies and sourcing strategies should support, not inhibit, an agency's efforts to recruit and retain a high-performing in-house workforce, as well as support its efforts to access and collaborate with high performance, private sector providers.⁴ Applying a strategic perspective to sourcing decisions by identifying all non-inherently governmental activities and related positions would provide work force planning data on the number and classification of personnel who could be affected by possible outsourcing.

To take a more strategic approach to outsourcing, we believe the Board should

- develop a set of “sourcing principles” to guide consideration of potential outsourcing opportunities, including the use of competitive sourcing, which allows existing units to compete for work that may be potentially outsourced;
- modify its current outsourcing policies to consider not only outsourcing's impact on effectiveness and efficiency but also its impact on workforce planning activities;
- require, as part of the budget process, a biennial assessment of all noninherently governmental functions using a consistent analytical framework to support decisions to retain in house, compete, or outsource these functions; and
- establish a monitoring mechanism to analyze outsourcing and competitive sourcing results to ensure that anticipated benefits are being achieved.

⁴ See the final report of the Commercial Activities Panel, *Improving the Sourcing Decisions of the Government*” April 2002, available at <http://www.gao.gov/a76panel/dcap0202.pdf>. The panel consisted of representatives from agencies, federal labor unions, and private industry, as well as other individuals with expertise in this area.

We provided a copy of this report to the Staff Director for Management and the General Counsel for review and comment. Their responses are included as attachments to this report. The responses indicate concurrence, in part or in principle, with the recommendations and discuss actions that have been taken or will be taken to implement the recommendations.

The Staff Director concurs in principle with recommendation 1, noting that the appropriate level of detail is generally included in each statement of work and contract. Nevertheless, MGT will continue to work with Board managers to identify areas where improved controls would be beneficial and cost effective, and to strengthen requirements for statements of work and performance measures developed by Board staff. The Staff Director and General Counsel both concur in part with our second recommendation. The Staff Director, with input from Legal, recently revised the Board's *Acquisition Policy* to more clearly define which contracts require Legal's review and the purpose of such reviews. The revised policy limits Legal's review of outsourced contracts to those that would result in positions being eliminated. Outsourced contracts that do not meet this criterion will undergo the normal process of review which is more clearly defined by the new policy. We believe that the combination of requirements in the revised policy is sufficient to help ensure that Legal reviews the majority of outsourced contracts. The Staff Director partially concurs with recommendation 3 and plans to review the Board's *Outsourcing Policy* this year to determine ways of accomplishing outsourcing more efficiently. Once the review is complete the director will seek additional opportunities for outsourcing. While we support these efforts, we continue to believe that the Board needs to develop a more strategic approach to outsourcing that includes a set of guiding principles, is linked to workforce planning activities, and incorporates a monitoring mechanism.

Major contributors to this report were Mr. Paul Zacharias, Project Manager; Mr. Kyle Brown, Project Leader; and Mr. David Horn, Auditor. We have provided copies of this report to Board officials and the report will be added to our publicly available web site at www.federalreserve.gov/oig. We will also summarize this report in our next semiannual report to Congress. Please contact me if you would like to discuss this report or any related issues.

Sincerely,

/signed/

Barry R. Snyder
Inspector General

Attachments

cc: Governor Edward Gramlich
Governor Donald Kohn
Mr. Stephen Malphrus
Mr. Virgil Mattingly
Ms. Fay Peters
Mr. Stephen Clark

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM



DATE: March 17, 2004
TO: Bill Mitchell
FROM: Virgil Mattingly and Steve Siciliano /signed/
SUBJECT: Draft Report on the Audit of the Board's Outsourcing Operations

You have requested the comments of the Legal Division on the Draft Report on the Audit of the Board's Outsourcing Operations. Overall, based on this draft report and prior OIG reviews of procurement practices, the Legal Division believes that the Management Division needs to take action to ensure that the Procurement Section operates in compliance with the Board's policies and procedures. However, the OIG's frequent recommendation that the Legal Division review all contracts in a particular category is not the answer. While we can assist in many areas of procurement, we do not have the expertise to assist in other areas, such as review of statements of work, technical requirements, or qualifications of vendors. These are the responsibilities of the Procurement Section and the relevant divisions. The following specific comments focus on recommendation 2, which refers specifically to the Legal Division.

We partially concur with recommendation 2. We note, however, that some of the activity referred to in recommendation 2 was not by or under the control of the Legal Division. Although we have from time to time discussed with the Procurement Section the need to submit matters for review in a timely fashion, we do not really control that process and are not in all cases aware of the reasons for untimely submissions.

Recommendation 2 is that the Legal Division review all contracts involving outsourced services to help mitigate legal risks. We believe that legal risks unique to outsourcing contracts occur chiefly, if not exclusively, when the contract would result in the elimination of filled Board employee positions. In recent discussions associated with the revision of the Acquisition Policy, the Legal Division and Management Division had agreed that Legal should review all such outsourcing contracts. When filled positions are not being eliminated, however, an outsourcing

contract is little different from other contracts; and the general standard for Legal Division review would seem more appropriate.

We have the following comments on individual bullet items under recommendation 2:

1. The first bullet item describes an outsourced contract for computer security reviews, and indicates that Legal's review "raised issues regarding the contract type and acquisition method after the vendor had nearly completed all work." We are familiar with the contract to which you refer. As you know, Legal never signed off on this procurement because it appeared that the Procurement Section did not follow proper Board procurement policy and procedures. This procurement began with two \$60,000 tasks, and then escalated rapidly to a \$650,000 commitment. Legal was not asked to review the procurement until after work began on the second modification for \$277,000; and before the issues were resolved with that modification, Procurement issued a third modification for \$250,000.

The first bullet also identifies a large dollar value competitive acquisition for printing services that was not given to Legal for review until the contract was about to be signed with the selected vendor. Documents regarding this matter have been provided separately to your office. We agree that matters should be submitted for review in a timely manner and sufficiently in advance of the action deadline to permit meaningful legal review.

2. The second bullet item discusses the Service Contract Act and obtaining wage determinations from the Department of Labor. We agree that the Board has been deficient in some cases in obtaining wage determinations under the Service Contract Act and the Davis Bacon Act, although a wage determination was obtained in connection with the janitorial maintenance contract. Compliance with these laws is addressed in the Board's general contract provisions, as it must be. We recall discussing the compliance problem with the Management Division in 2002 and 2003, and urging that compliance be improved. In this connection, in 2002, Legal assisted Management Division in obtaining a wage determination for a contract involving the shipment of currency to Reserve Banks. During the period in which the wage determination was being sought, Legal met with management and outlined the types of contracts to which the Service Contract Act, the Walsh-Healey Act, and the Davis Bacon Act, are applicable. In light of the Inspector General's finding, we believe this issue now should be flagged routinely by Management Division and Legal Division.

3. The third bullet states that written determinations of the applicability of common law factors to the employment status of individuals are not always included with contracts where appropriate. It is our practice that consultant contracts that come to the Legal Division for review, where the contract is with an individual, must have a completed “*Factors To Consider In Determining Whether An Individual Is A Common Law Employee Of The Board*” before the contract may be approved by Legal.⁵ In addition, as a general matter, we have regarded employees of companies who contract to provide such employees for Board service on a temporary basis as not being common law employees. The audit findings raise the question of whether individuals who perform work for the Board under Basic Ordering Agreements (“BOAs”) could be viewed as common law employees of the Board resulting in the necessity of withholding appropriate taxes from their wages and reporting such wages to the IRS and other governmental authorities.

It is our understanding that when individuals perform work for the Board pursuant to either a BOA or through a leasing organization the Board is not contracting with the individuals to perform the services but instead with a corporate organization that originally hired such individuals. If this is the case, Legal does not believe it needs to review the circumstances of each individual who performs work for the Board under such contracts. While the law is not well developed in this area, there is case law to support the proposition that the individuals are not employees of the Board but of the corporation that the Board contracts with. *See, e.g., Sargent v. Com’r*, 93 T.C. 572 (1989), *rev’d* 929 F.2d 1252 (8th Cir. 1991).⁶

The IRS has recognized this proposition by stating in its auditor training manual that when there is “at least one non-tax business purpose” for formation of the corporation, “the corporate form is generally recognized for both state law and federal law, including federal tax, purposes. Disregarding the corporate entity is generally an extraordinary remedy, applied by most courts only in cases of clear abuse. Thus the worker will usually not be treated as an employee of the business, but as an employee of the corporation.” *Independent Contractor or Employee?* Training Materials, IRS Training Course 3320-102, TPDS 842381 (Oct. 30, 1996), p.2-23.⁷ Accordingly, the Legal Division believes review of each individual’s

⁵ We do not require this of visiting scholars, who obviously are not common law employees.

⁶ For a case that reaches the opposite conclusion, *See Leavell v. Com’r*, 104 T.C. 140 (1995).

⁷ Legal has not been advised of any facts that would suggest that the corporations with which the Board contracts were formed for purposes of tax evasion.

work status under such contracts is unnecessary. However, it would be useful to ensure that each contract contains language that clarifies that the individuals who perform work for the Board under such contracts are employees of the contracting corporation, not the Board, and that such corporation will withhold and pay all employment taxes associated with such individuals as well as maintain workers' compensation insurance with regard to such individuals. It would also be helpful to ensure by appropriate provision in each contract that such corporations hold the Board harmless with respect to any tax liabilities (or other types of employment related claims) regarding these individuals.

4. The fourth bullet states that a standard set of contract provisions is included in most contracts, even when some provisions are not applicable to that contract. This has been the Board's practice for many years. It is our understanding that each contract states that only those applicable provisions of the standard contract provisions should be considered as part of the contract. In a paper-based world, this was the most efficient means of providing all applicable provisions to contractors. In the future, it may be possible to consider the feasibility of "customizing" the contracts.

5. The final bullet states that documentation of Legal's review is not always included in the contract file. This comment is more appropriately addressed by Management Division.

Legal Division has no issues to raise with regard to recommendations 1 and 3. We agree, of course, that statements of work and award evaluation criteria must be sufficiently detailed and precise to protect the Board's interests.

We have discussed our comments with staff in the Management Division. If you have any questions about our comments or wish to discuss them further, please contact either Steve Siciliano at 452-3920, or Elaine Boutilier at 452-2418.



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
MANAGEMENT DIVISION

DATE: March 18, 2004
TO: Mr. Barry Snyder
FROM: H Fay Peters and Stephen R. Malphrus
SUBJECT: Response to OIG's Audit of Outsourcing Operations

We appreciate the opportunity to comment on the draft report of your audit of the Board's Outsourcing operations. We concur with some of the findings and feel that they have already been implemented where appropriate. The following comments provide additional perspective on the findings and proposed management actions.

- 1. We recommend that the Management Division (MGT) enhance controls to ensure that statements of work and contracts for outsourced services specify the expected vendor performance, results, and level of service; standards for performance measurement; and incentives or penalties, as appropriate, based on the actual level of vendor performance.**

Summary

Concur in principle. Management believes that in large measure the recommendation is already in place and that the appropriate level of detail is generally included in each statement of work (SOW) and contract. Not all statements of work require the level of detail specified in the recommendation. Where useful, such as in the cafeteria contract, such controls are already in place. At the conclusion of every contract the COTR is required to evaluate the vendor's performance. None of these reports indicate that performance has failed to meet the division's needs because of an inadequate SOW. Nevertheless, Management will continue to work with Board managers to identify areas where improved controls would be beneficial and cost effective, and will strengthen requirements for the statement of work and performance measures developed by Board staff.

Discussion

Where beneficial, Procurement works with the requesting division to develop a performance based statement of work. However, such a SOW is not necessary for all contracts and in some cases the opportunity cost is high. Examples of cases where the SOW and subsequent contract administration do not require this level of detail include the shuttle service and maintenance of the grounds. In these cases, using the specifications in the contract, the COTR oversees the work and makes sure that it complies with contract specifications. A less obvious example is the contract for the distribution of the FRB Bulletin which the requesting division has chosen to build around detailed specifications. These specifications describe how data will be provided to

the vendor, how the vendor will provide information to the Board, and exactly how the Bulletin will be printed. Other contracts are for services, where certain levels of performance are mandated. For example, the contract for the vendor handling the reimbursement of medical expenses needs to be explicit. In this case the service is either performed with 100 percent accuracy or not. There is no gain for performance above the requirement and performance below the requirement is unacceptable.

Most contracts need enough flexibility to allow for differing conditions and events that cannot be foreseen. Contracts for consultants by their nature cannot be detailed as to their specific recommendations. While the contract will describe the overall task, the general support or technical expertise needed, a schedule with milestones if possible, and some kind of deliverable (report, computer program, etc.), requirements may evolve during the course of the contract as work is performed that necessitate changes in the terms of the contract. Contracts where the Board retains auditors may require additional work if issues are found or general practices need to be revised.

Even with controls such as those suggested by the OIG, service is not always acceptable. For these reasons, all government and Board contracts contain an acceptance clause and a termination for default clause. If the work is not acceptable it must be redone. If a vendor fails to do the work correctly the first time, they are required to correct it before any payment is made. If the vendor continues to perform the work incorrectly, it could result in the loss of the contract. While Board contracts contain a termination for default clause, the most effective method that the Board uses to enhance performance is to award one-year contracts with multiple year options. This creates a market incentive to perform at the highest levels each year. If the contractor performs poorly, the contract will not be renewed, which is less costly than trying to terminate the contract for convenience or default. Another control is that contractors who do not perform are not asked to bid on new contracts.

Without exception, contracts are reviewed and approved by the division requesting the goods or services before they are issued. Procurement makes every effort to involve the division in crafting SOWs that include schedules, acceptance terms, performance standards, and specifications. The division's officers have the technical expertise and are best positioned to evaluate the contractor's performance.

Consistent with the OIG recommendation, Procurement will continue to stress performance specifications and incentives. Where appropriate these will be reflected in the SOWs and resulting contracts. Additionally, Procurement will work with divisions to provide training to appropriate staff and will review the resulting work products and identify areas for improvement to COTRs and division directors.

2. We recommend that LEGAL review all contracts involving outsourced services to help mitigate legal risks

Summary

Concur in part. Legal is also reviewing this finding.

The Outsourcing Policy requires that both the Legal Division and the Equal Employment Opportunity Programs Office review contracts involving outsourcing services. We plan to revise

the policy to limit those reviews to situations where positions are being eliminated. When no positions are being eliminated, the normal process of review by the Legal Division will be followed.

Staff in the Management and Legal Divisions worked for some time to revise the Acquisition Policy. The Staff Director for Management recently approved the new policy after sending it to division directors and incorporating changes based on their comments. The policy clarifies the purpose of the Legal Division review and defines Legal risk. In the six years that the present management team (Procurement Manager and oversight officer) has been in place, the volume of contracts has expanded by approximately 34 percent. Moreover, during this time, the Board has not been sued over any contract nor have there been any bid protests.⁸

Discussion

The former Acquisition policy required a legal review of all procurements over \$250,000 and cost-reimbursement procurements over \$50,000. (The Board has not issued a cost-reimbursement contract in over ten years.) Because the Board uses options to create multi-year contracts, the new policy clarifies that the thresholds are annual which should reduce confusion over whether a contract should be forwarded to Legal for review. This also ensures that the volume of contract reviews does not result in undue costs which are out of proportion to the benefits obtained. The new policy requires a review by the Legal Division when: a) the annual cost of a contract is \$100,000 or more; b) the contract is sole source for \$50,000 or more; c) a cost reimbursement contract is issued; d) when outsourcing will occur that will eliminate positions; or e) when intellectual property rights are involved.

The support for this recommendation cited some specific problems that are summarized below:

- computer security contract The initial amount was for \$60,000, well under the threshold for Legal review. In addition, this contract used a GSA negotiated contract as its base. There are other issues associated with this contract which are being reviewed separately by the OIG and will be discussed in detail when that report is issued. Nevertheless, the services required were performed well, obtained at reasonable cost, and enabled the Board to meet a Congressionally mandated deadline in a timely manner.
- large dollar competitive acquisition for printing services. This was a competition for routine services provided under a contract that was expiring. The requirements with two exceptions (the number of pages and electronic transmission of the documents) had not changed since Legal reviewed the identical request for proposal a few years earlier. It was forwarded to the Legal Division prior to contract award when a reviewing officer realized that it had not been reviewed in accordance with the Acquisition Policy.
- compliance with the Service Contract Act (SCA). Since May of 2002 we have included the SCA requirements in our contracts and have followed the procedures required by that law and further work is planned to improve compliance.
- common law factors. With the Legal Division we have a stringent process for reviewing contracts with individuals and frequently find that they are common law employees. In the case of Basic Ordering Agreements we are dealing with firms that

⁸ In connection with the Eccles Building infrastructure contract, the Board acted on a request for equitable adjustment filed by a subcontractor of the general contractor. Because our detailed specifications had not been followed the Board suffered no loss. The last suit against the Board involved a contract issued in 1988 which was successfully defended by the Legal Division.

provide staff to meet needs identified in our contract and follow-up task orders. Payments are made to the firms with which the Board has a contract, not to the individual.

- standard set of contract provisions. It is common practice in the Federal Government to include in all contracts a basic set of standard clauses. It is acknowledged that every clause may not apply in every case. It is a prudent practice to include all normal clauses that might pertain to procurements as it reduces the Board's risk. In addition, the effort required to edit the basic clauses for every purchase order (PO) and contract would be impractical, and under the current software used by Procurement impossible for POs. Vendors familiar with Government procurement know that they can ignore the clauses that are not relevant or appropriate and seek clarification when they feel that the clauses result in any ambiguity.
- legal documents in contract file. The Procurement office provides a sign-off sheet for each contract which is included in the contract file. Separate memoranda should be included in the file along with the sign-off sheet and Procurement is responsible for seeing that this is accomplished. Under the prior Acquisition Policy, the Management Division was responsible for interpreting the policy; this included ensuring that comments were analyzed and incorporated when appropriate.

A previous audit (A0203) is mentioned in support of the current recommendations and the concerns raised by Management about the recommendation are re-stated. Management and Legal staff worked to revise the Acquisition Policy to define more clearly which contracts require a review by the Legal Division and to state clearly the purpose of such reviews. Drafts of the policy were reviewed by the OIG and Division Directors and the new policy has been approved.

3. We recommend that the Board develop a more proactive, strategic approach to outsourcing that is linked to workforce planning activities.

Summary

Partially concur. Management believes that the Board already employs a strategic approach to outsourcing. The issue was raised by the Staff Planning Group in the questions posed to each division during the 2004-07 strategic planning cycle. The current level of outsourcing is consistent with the Board's policy for outsourcing.

Discussion

As the report notes, outsourcing was specifically raised with each division by the Staff Planning Group. We believe that outsourcing has been accomplished in those areas where it makes sense financially and does not pose a risk to the operations of the Board. Some examples include our strategy to purchase large quantities of data rather than gather them ourselves, contract for surveys in specialized areas, and contract for staff to meet peak loads in the information technology area. We have outsourced a number of functions including food services, specialized human resources management support, facilities and automation maintenance, mail handling, grounds keeping, and transportation and courier services. We contract with Federal Reserve Information Technology to provide a large portion of network services. In other cases contracted services provided a bridge until a function such as physical security could staff up. Only Board

employees can receive federal law enforcement authority under the law. Contract security forces do not have such authority. The value of such law enforcement authority was a key factor in the decision to discontinue the use of contract security officers.

The report notes that the Board feels that accounting, payroll, and procurement activities should not be outsourced and states that such outsourcing is occurring at other agencies. Payroll is outsourced at the other Federal Financial Institution Examination Council (FFIEC) agencies but procurement and accounting are not outsourced in three of the other four FFIEC agencies. The report also notes the strategic implications facing government agencies as they face large numbers of retirements. Strategic management of human resources is a very high priority of the Board and steps taken to attract and retain staff have been very effective but have also complicated payroll and related benefits to the point that outsourcing is not feasible at this time. The Board's relationship to federal programs such as health insurance, and System benefits such as retirement move the Board from the standard model employed by other federal agencies, thus outsourcing does not have the same scale benefits. These factors also influence accounting. Management has looked at these issues and has concluded that outsourcing these functions is not feasible at this time.⁹ Procurement is an area that management considers to be an inherently governmental function, thus it will not be outsourced.

We do plan to complete a review of the Board's Outsourcing Policy this year to determine if there are ways that it can be improved to facilitate more efficient outsourcing and to consider demographics of the Board's workforce. After that review, we will look to see if there are additional areas where outsourcing should occur and what actions would be needed to facilitate any desirable outsourcing.

⁹ Payroll is an integral part of our automated workforce management tool. In conjunction with the Reserve Banks, we actively looked at outsourcing payroll. The complexity of our government and private sector character as well as some legal issues precluded our joining with the Banks (which have consolidated payroll) or contracting with the private sector for this support.